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INTERNATIONAL COUNTERTRADE

Draft Legal Guide on International Countertrade Transactions

Report of the Secretary-General

Addendum

VIII. PARTICIPATION OF THIRD PARTIES

Contents

	Paragraphs
A. General remarks	1-3
B. Purchase of countertrade goods	4-40
1. Countertrade agreement	9-20
(a) Selection of third party	12-16
(b) Liability for fulfilment of countertrade commitment	17-20
2. Contractual relationship between party originally committed and third party	21-40
(a) Third party's commitment to purchase goods	21-29
(b) Third party's fee	30-36
(c) "Hold-harmless" clause	37
(d) Exclusivity of third party's mandate	38-40
C. Supply of countertrade goods	41-52
(a) Selection of third party by party committed to purchase	45-46
(b) Selection of third party by party committed to supply	47-52
D. Multi-party countertrade	53-58

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[Editorial note: The present draft chapter VIII is a revision of draft chapter VIII, "Participation of third parties", published as document A/CN.9/WG.IV/WP.51/Add.1. The note in square brackets at the beginning of each paragraph indicates either the number under which the paragraph appeared in document A/CN.9/WG.IV/WP.51/Add.1 or that the paragraph is new. The revisions of paragraphs that appeared in document A/CN.9/WG.IV/WP.51/Add.1 are underlined. An asterisk indicates the place where text has been deleted without adding new language. An asterisk indicates the place where text has been deleted without adding new language.]

A. General remarks

1. [1] This chapter deals with cases in which a party, instead of itself purchasing or supplying goods in a particular direction, engages a third party to do so. Section B discusses the case in which a party originally committed to purchase goods engages a third party to make those purchases. Section C discusses the case in which a third party is designated to supply goods.

2. [1] This chapter also discusses cases in which a supplier of goods in one direction does not assume a commitment to purchase goods in the other direction, but instead a third-party purchaser assumes such a commitment from the outset of the transaction; such cases are dealt with in section D. Section D also discusses cases in which a purchaser of goods in one direction does not assume a commitment to supply goods in the other direction, but instead a third-party supplier assumes such a commitment from the outset.

[Some of the substance of paragraph 2 as it appeared in A/CN.9/WG.IV/WP.51/Add.1 was moved to paragraph 5.]

3. [3] Cases in which the party committed to purchase goods makes those purchases itself and then resells the goods are not within the subject-matter of this chapter, since those cases are not specific to countertrade. Various restrictions that may be placed on the resale of countertrade goods are discussed in chapter X.

B. Purchase of countertrade goods

4. [4] A party committed to purchase goods frequently cannot use the goods to be purchased, or lacks the marketing capacity or knowledge necessary to resell them. In these cases the party committed to purchase may wish to engage one or more third parties to make the purchases necessary to fulfil the commitment. The third party may be, for example, an end-user of the goods or a trading company specializing in the purchase and resale of certain types of goods.

5. [new paragraph] This section discusses only cases where the third party is to enter into a purchase contract with the supplier. Not discussed are cases in which the party committed to purchase engages a third person to perform the service of locating persons to whom the goods could be resold or the service of representing the committed party in the resale of the goods. Such services performed by a third person, which are not specific to

countertrade, do not affect the rights and obligations of the parties under the countertrade agreement and are therefore not a matter to be addressed in that agreement.

6. [5] A third-party purchaser who agrees to become involved in the countertrade transaction makes a commitment to the party originally committed (i.e., only to the party who engages the third party) to purchase goods from the supplier within an agreed period of time. In some cases, the third party also makes a commitment to the supplier to enter into future contracts. Since the third party's commitment relates to the conclusion of future contracts, that commitment would address issues such as the type, quality, quantity and price of the goods to be the subject of the future contracts, period for fulfilment of the commitment, restrictions on resale of the goods, security for performance, liquidated damages or a penalty, and settlement of disputes. While the third party's agreement to enter into a future contract with the supplier may address the same type of issues as are addressed in the countertrade agreement between the supplier and the party originally committed, the content of the solutions in the two agreements would not necessarily be the same. Different solutions might be adopted, for example, as to security for performance, liquidated damages or a penalty, the applicable law or the settlement of disputes. (Implications of the commitment by the third party are discussed below in paragraphs 17 and 18; the terms of the third party's commitment are discussed below in paragraph 22.)

7. [6] When a third-party purchaser is to be engaged, it is often the case that payment obligations under the supply contracts in each direction are to be settled independently. Such cases do not raise payment issues specific to countertrade. It may be agreed, however, to link payment in the two directions so that the proceeds of the supply contract in one direction are used to pay for the supply contract in the other direction. For a discussion of such linked payment mechanisms, see chapter IX, "Payment", paragraphs 68 and 76.

8. [7] Sometimes the parties to the countertrade agreement agree that the party making purchases beyond what is required to liquidate its outstanding countertrade commitment will be allowed to have the excess fulfilment credit counted towards fulfilment of countertrade commitments that the purchaser may have to assume in the future. Alternatively, a purchaser accumulating such excess fulfilment credit may be permitted to transfer the excess fulfilment credit to a third party (for a discussion of fulfilment credit, see chapter IV, "Countertrade commitment", paragraphs 31 to 34). The transfer of the fulfilment credit to a third party would entitle that third party to sell goods to the party who originally granted the fulfilment credit and to reduce any countertrade commitment by the amount of the transferred fulfilment credit. Such a transfer may involve the payment of a fee by the third party to the transferor of the fulfilment credit. In some countries, special regulations exist on the right of transfer of countertrade credit (e.g., restricting the types of exports that can generate transferable credits, the types of parties to whom countertrade credit may be transferred, the types of imports against which transferred credits may be applied, or requiring specific authorization).

1. Countertrade agreement

9. [8] When the parties at the outset of the transaction foresee the possibility that the party committed to purchase will wish to engage a

third-party purchaser, it is advisable to address that possibility in the countertrade agreement. Provisions concerning a third-party purchaser are particularly advisable when, as described in the next paragraph, the parties might have differing expectations as to whether the purchaser is free to engage a third-party purchaser.

10. [new paragraph] If the countertrade agreement does not address the participation of a third-party purchaser in the fulfilment of the countertrade commitment, the issue may arise between the parties as to whether the party originally committed to purchase is free to engage a third party to make the purchases. The solution to the issue would in many national laws be found in general principles of contract law, according to which a contract party is entitled to involve a third party in the performance of a contractual obligation without having to obtain the consent of the party entitled to the performance. Consent, however, would be required under those general principles if, in the circumstances of the case, the party entitled to the performance had a legitimate reason to insist that the obligation should be performed by the party originally committed. Such a legitimate reason might exist when, because of special properties or capabilities of the obligated party, the performance of the obligation by a third party would in some way diminish the value of the performance. For example, the supplier of countertrade goods might consider that, because of the reputation and existing resale network of the party committed to purchase, the resale of the goods by that party was essential for establishing a long-term place for the goods in the market or for maintaining the market image of the goods.

11. [9] The participation of third parties in the fulfilment of countertrade commitments may be subject to mandatory rules. Such rules may make the participation of third parties subject to consent by the supplier, impose guidelines as to the acceptability of third parties or require governmental authorization of third-party participation. A frequent reason for such restrictions is the desire to ensure proper implementation of the countertrade transaction or to prevent the marketing of the goods in traditional export markets of the State in question.

(a) Selection of third party

12. [10] Clauses in the countertrade agreement permitting the engagement of third parties may be formulated in such a way that the party originally committed to purchase goods is free to select the third party. In such clauses it is advisable to provide that notice of the engagement of a third party must be given to the supplier in advance of the purchases by the third party.

13. [11] Sometimes the countertrade agreement limits the freedom of the party originally committed to purchase goods to select the third party. Various types of limitations may be used. For example, the countertrade agreement may name the third party, list acceptable third parties, or stipulate the criteria to be followed in selecting the third party. Where the countertrade agreement names the third party or contains a short list of potential third parties, the countertrade agreement may provide for the selection of another party if the identified third parties are not in a position to purchase the goods.

14. [12] Another way of limiting the freedom to select a third party is to provide that the party originally committed to purchase goods is not permitted to engage a third party without the consent of the supplier. To expedite the designation of the third party, it may be agreed that the supplier will be deemed to have consented to the designation unless an objection is raised within a specified period of time. The countertrade agreement may indicate the type of information about a proposed third party that the party originally committed to purchase is obligated to furnish to the supplier (e.g., financial standing of the proposed third party and type and quantity of goods to be purchased). In order to limit the discretion of the supplier, the countertrade agreement may identify the types of objections that would be acceptable. Such acceptable objections might be, for example, that the proposed third party is already the supplier's trading partner, that the third party is selling goods produced by competitors of the supplier, or that the third party previously has failed to meet an obligation owed to the supplier or has been involved in a dispute with the supplier.

15. [13] The supplier may have various reasons for wishing to limit the freedom of the party originally committed to purchase in the selection of a third party. One category of reasons is aimed at preventing the selection of certain third parties. For example, restrictions may be designed to prevent sales to existing customers from being counted towards fulfilment of the countertrade commitment, to prevent the engagement of persons active in a particular market (e.g., because of existing distributorship agreements in the market or because of rules applicable to trade with that country), or to ensure that goods requiring special precautions in their use are not purchased by parties not trained to handle them. The other category of reasons is aimed at bringing about the selection of certain third parties. For example, a restriction may be designed to obtain the selection of a third party from a particular country or market or of a third party with experience in particular products or markets (e.g., because the supplier wishes to introduce the goods in a market).

16. [14] The parties should bear in mind, however, that a limitation on the purchaser's freedom to select a third party may have disadvantages. For example, the party originally committed to purchase goods might have to factor into the costs of the transaction the risk that the fee charged by the third party in connection with the purchase of the countertrade goods (see below, paragraphs 30 to 36) might be higher than fees charged by other third parties or the risk that the third party will fail to make the purchases. The parties may agree that some of these risks will be assumed by the supplier who insists on the selection of a particular third party. For example, it may be agreed that the liability of the party originally committed under the liquidated damages or penalty clause would be reduced to the amount that that party could recover from the third party.

(b) Liability for fulfilment of countertrade commitment

17. [15] It is advisable for the parties to the countertrade agreement to address in the countertrade agreement the question of who would be liable to the supplier in the event of a failure by the third party to make the purchases needed to fulfil the countertrade commitment. The answer to that question depends on whether the third party has made a commitment to purchase goods only to the party engaging the third party or whether the third party has also made a commitment to the party who is to supply the goods (see above, paragraph 6).

18. [16] When the third party's commitment is made only to the party originally committed, the party originally committed remains liable to the supplier for its countertrade commitment even though the third party has been engaged. When, however, the third party makes the commitment both to the party originally committed and to the supplier, two approaches with respect to the commitment of the party originally committed may be considered. One approach is to stipulate in the countertrade agreement that the commitment of the party originally committed to purchase is to be maintained; in such a case, both the party originally committed and the third party will be liable to the supplier for the fulfilment of the commitment, and, ultimately, the party originally committed and the third party would settle the question of responsibility between themselves pursuant to their contract. Such an approach might be appropriate where the third party's commitment to the supplier to conclude future purchase contracts is not supported by the same guarantees as is the countertrade commitment of the party originally committed, or where the supplier has had no experience or has had unsatisfactory experience in dealing with the third party. The other approach is to stipulate that, upon the assumption of the commitment by the third party, the party originally committed will be released from the countertrade commitment, leaving only the third party liable to the supplier for the conclusion of future contracts. In order to implement such a substitution of the party liable to the supplier, the parties may agree on a transfer of the countertrade commitment from the party originally committed to the third party. The general contract law of most countries contains rules on transfers of contractual obligations that would be relevant to a transfer of a countertrade commitment. An alternative method of substituting the party liable to the supplier would be for the party originally committed and the supplier to agree to terminate their countertrade commitment at the moment the third party assumes a commitment to conclude future contracts with the supplier. To ensure that the original countertrade commitment is not terminated before the third party's commitment becomes effective, it is advisable to stipulate in the countertrade agreement that the termination would not take effect until the third party's commitment had become effective.

19. [17] As noted below in paragraph 22, third parties sometimes limit their commitment to a promise to exercise "best efforts" to make the purchases. Where it is agreed that the countertrade commitment of the party originally committed is to be terminated when the third party commits itself to enter into a future contract with the supplier, it would be in the interest of the supplier to agree to such a replacement of the party committed to purchase only if the commitment of the third party is a commitment to actually purchase goods rather than a "best efforts" type of commitment. If the third party were to make only a "best efforts" commitment, the supplier would have limited assurance that the conclusion of the supply contract would take place.

20. [18] Guarantees issued to support fulfilment of countertrade commitments are normally formulated in such a way that they cover only the obligation of the party originally committed. Therefore, if the supplier wishes to have the third party's commitment secured, it is advisable that the countertrade agreement require that the guarantee be modified or that a new guarantee be issued. It is also advisable that there be an indication of the consequences if the guarantee cannot be modified or an appropriate new guarantee cannot be procured.

2. Contractual relationship between party originally committed and third party

(a) Third party's commitment to purchase goods

21. [19] When the party originally committed to purchase intends to engage a third party to make the purchases, those two parties should reach an understanding as to the type of commitment to be made by the third party.

22. [20] Two types of commitment by third parties to parties originally committed are used in practice. One type is a promise that, subject to the terms of the engagement of the third party, the countertrade goods will actually be purchased. The other type of commitment is a promise by the third party that an effort will be made to purchase goods without an assurance that the effort will be successful. The third party may not be willing to make a full commitment because of uncertainty as to whether an end-user for the goods could be found or whether the purchase price of the goods would be competitive. Such a promise only to make an effort may be described by terms such as "serious intention", "best endeavours", "best efforts", or "good-faith efforts" or by a clause to the effect that the third party will purchase the goods if an end-user for the goods can be found. If the third party fails to purchase the goods, it can exonerate itself from the consequences of the failure merely by showing a good faith effort to carry out its mandate. The party originally committed to purchase the goods may find the participation of the third party on a "best efforts" basis acceptable if there is reason to expect that the third party will fulfil the mandate (e.g., because of the third party's record or because the anticipated purchase and resale prices are likely to make the purchase commercially attractive).

23. [21] Sometimes the terms of the contract engaging the third party require the third party to make a commitment directly to the supplier to conclude future contracts (see above, paragraphs 6 and 17).

24. [22] The terms under which the third party is engaged should be coordinated with the terms of the countertrade agreement. The need for coordination exists in particular with respect to the type, quality, quantity and price of the countertrade goods. A problem may arise, for example, if the third party commits itself to purchase goods of a standard quality at a world market price, while the countertrade agreement specifies a different level of quality or price. In such a case, it may occur that the supplier makes available goods that conform to the countertrade agreement but that the third party is justified in refusing to purchase because the goods do not conform to the terms of the contract between the party originally committed and the third party. That would leave the party originally committed to purchase liable to the supplier for non-fulfilment of the countertrade commitment without the possibility of indemnification from the third party.

25. [23] Furthermore, a problem may arise when the countertrade agreement does not contain an assurance as to the availability of the goods but the third party, relying on its contract with the party originally committed, expects the goods to be made available. When such inconsistency exists, the party engaging the third party may be liable to the third party for a failure on the part of the supplier to make the goods available.

26. [24] When the countertrade agreement and the terms of the engagement of the third party both contain an assurance as to the availability of goods, the party originally committed may be liable to the third party for a failure by the supplier to make the goods available. In such a case, the party originally committed would be interested in making the assurance of the availability of the goods subject to a liquidated damages or penalty clause or secured by a guarantee.

27. [25] It is advisable for the contract by which the third party is engaged to reflect any restriction on the resale of goods set out in the countertrade agreement. Otherwise, the party originally committed to purchase may be liable for a resale of the goods by the third party in violation of a restriction set out in the countertrade agreement without the benefit of indemnification from the third party.

28. [26] In some cases, the party originally committed may wish to have an opportunity to make alternative arrangements to fulfil the countertrade commitment in the event that the third party fails to make the necessary purchases. This could be achieved by setting a deadline for purchases to be made by the third party that precedes the deadline for the fulfilment of the countertrade commitment that is binding upon the party originally committed. If the party originally committed wishes to have such an opportunity, it would be advisable, in negotiating the countertrade agreement, to ensure that the fulfilment period is of a sufficient length so as to allow the third party adequate time to make the purchases, as well as to allow time for alternative arrangements to be made should the third party fail to make those purchases.

29. [27] It is advisable to make it clear in the contract for the engagement of the third party whether it is up to the third party to carry out all aspects of the negotiation with the supplier relating to the conclusion of the future contract, or whether the party originally committed to purchase the goods should participate in some way in the conclusion or performance of the contract. It may be provided, for example, that the party originally committed to purchase must approve or at least be informed of a particular aspect of the purchase of the goods (e.g., the price or the destination of the goods).

(b) Third party's fee

30. [28] In return for the third party's commitment to purchase goods, the party originally committed may have to pay a fee to the third party. A fee, to be agreed upon in the contract between the party originally committed and the third party, is normally required when the price of goods to be purchased by the third party is not competitive and the resale of the goods would therefore not be profitable to the third party without the payment of a fee. Such a fee is referred to in practice by expressions such as "commission", "disagio", "subsidy", "discount", "premium", or "compensation". The amount of the fee would depend in particular on the demand for the type of goods in question and on the expected difference between the purchase price and the resale price of the goods. The amount of the fee may also be affected by the cost of any guarantee that the third party would have to procure to cover its liability either to the party originally committed or to the supplier, or to both, for a failure to make the necessary purchases.

31. [new paragraph] In some jurisdictions, when a governmental agency is engaging a third party to purchase goods or when a governmental agency is being engaged to purchase goods, mandatory restrictions apply to the payment of a fee by or to the governmental agency.

32. [29] The fee may be calculated as a percentage of the price of the purchases to be effected by the third party or as an absolute amount per unit or quantity of goods. Sometimes a combination of the two methods is used. If the fee is calculated as a percentage of the price of the goods, it is advisable for the parties to be clear as to the amount on the basis of which the fee is to be calculated (e.g., whether any transport or insurance costs form part of that price).

33. [30] At the time the third party is engaged to conclude the future supply contracts, it may be difficult, due to price fluctuations, to predict the resale price. The parties may therefore provide for a variable fee, to be determined on the basis of the actual difference between the prices, increased by an agreed percentage or amount to cover the third party's costs. Depending upon the underlying commercial circumstances, the parties may wish to consider the possibility that the resale price might rise to a level at which the resale of the goods is profitable for the third party. If this possibility is taken into account, the third party would have to pay an amount to the party originally committed to purchase the goods corresponding to the extent to which the actual resale price increased above the anticipated resale price. Such an amount due from the third party is sometimes referred to as a "negative disagio".

34. [31] It is advisable to specify the point of time when the fee becomes due. It may be provided, for example, that the fee becomes due when the third party is engaged, upon the conclusion of the supply contract between the supplier and the third party, upon the opening of a letter of credit on the instructions of the third party in favour of the supplier, or at the time of payment by the third party to the supplier. Sometimes it is agreed that specified percentages of the fee are payable at different points of time. For example, it may be agreed that a certain percentage of the fee is payable upon the engagement of the third party, a certain percentage upon the conclusion of the contract between the third party and the supplier, and the remainder upon payment by the third party for the goods. When the fee is to be paid subsequent to the conclusion of the contract between the party originally committed and the third party, the third party may request a bank guarantee to secure the obligation to pay the fee.

35. [32] It is advisable for the contract engaging the third party to stipulate whether the contractual relationship between the third party and the party originally committed would be affected by a termination or reduction of the countertrade commitment of the party originally committed. A termination or reduction of the countertrade commitment may result, for example, from the termination of the export contract (see chapter XIII, "Failure to complete countertrade transaction", paragraph). The third party may be interested in completing the purchase and earning the fee irrespective of the fate of the countertrade commitment of the party originally committed, particularly when expenses have been incurred in locating an end-user, when an end-user has been promised the goods or when the goods have actually been purchased and resold. The party engaging the third party, on the other hand, may be interested in being able to terminate the engagement of the third party in the event that the countertrade commitment is terminated.

36. [new paragraph] Sometimes it is agreed that the payment of the fee is to be shared by the party committed to purchase and the supplier. In such a case, the details concerning the sharing, including any limit to the costs to be borne by the supplier, should be dealt with in the countertrade agreement.

(c) "Hold-harmless" clause

37. [33] The party originally committed to purchase goods may be liable to the party to whom that commitment is owed when the third party fails to make the anticipated purchases (see above, paragraphs 17 and 18). A party originally committed to purchase goods engaging a third party may therefore wish to include in its contract with the third party a "hold-harmless" clause. According to such a clause, the third party would have to indemnify the party originally committed to purchase for any liability to the supplier resulting from non-fulfilment of the countertrade commitment for reasons imputable to the third party. The parties may also stipulate that the "hold-harmless" clause would protect the party originally committed to purchase goods in the event of a violation by the third party of a restriction on the resale of the goods set out in the countertrade agreement and reflected in the contract engaging the third party. It may be agreed that the party originally committed to purchase the goods is to give the third party notice when a claim is raised that may result in the third party's liability under the "hold-harmless" clause.

(d) Exclusivity of third party's mandate

38. [34] It is advisable for the party originally committed and the third party to indicate in their contract whether the third party is to be the only party engaged or whether the party originally committed reserves the right to engage an additional third party for the purpose of fulfilling the same countertrade commitment. A third party could be given an exclusive mandate with respect to all the purchases to be made in fulfilment of the countertrade commitment or exclusivity could be given only with respect to a particular type of goods, a particular supplier, or a particular territory where the goods are to be purchased or resold.

39. [35] When the third party is given an exclusive mandate, the party originally committed may wish to reserve the right to declare the mandate as non-exclusive if by a specified time before the end of the fulfilment period the third party has not purchased an agreed quantity of goods.

40. [36] When the quantity of goods to be purchased is particularly large, it might be agreed that during a specified period of time the third party is not permitted to purchase the same type of goods from other sources. A rationale for such a restriction may be the desire to avoid a temporary oversupply in the market in which the third party plans to resell the goods, or a desire to compel the third party to concentrate its efforts on the fulfilment of the commitment in question.

C. Supply of countertrade goods

41. [37] Sometimes, a party who purchases goods in one direction, does not supply goods in the other direction. Instead, one or more third parties are designated to supply the goods. There are two types of transactions in

which such an approach may be used. One type is a transaction in which the party purchasing goods in one direction assumes a commitment for the supply of goods in the other direction, but because of difficulties in making the agreed goods available designates a third party to supply the agreed goods. The other type is an indirect offset transaction as described in chapter II, "Scope and terminology of Legal Guide", paragraph 17. In indirect offset transactions it is foreseen at the time of the conclusion of the export contract and of the countertrade agreement that the importer (often a governmental agency) will not counter-export goods and that the party committed to counter-import will have to locate third parties willing to supply goods. Those third parties are normally not bound by any commitment to conclude supply contracts with the counter-importer.

42. [38] In a transaction involving a third-party supplier, payment obligations under the supply contracts in the two directions are often settled independently. Payment in such a manner does not raise issues specific to countertrade. However, issues specific to countertrade do arise when the parties decide to link payment in the two directions so that the proceeds of the supply contract in one direction are used to pay for the supply contract in the other direction. For a discussion of such linked payment mechanisms, see chapter IX, "Payment", paragraphs 68, 75 and 76.

43. [39] When the possibility exists that a third party may be involved in the supply of goods, it is advisable for the countertrade agreement to address the means by which the third party supplier is to be selected and the consequences of a failure by the third party to make the agreed goods available.

44. [40] Different approaches may be used for the selection of the third party supplier. One approach is for the countertrade agreement to name the third party. Another approach is for the countertrade agreement to stipulate that the third party supplier is to be agreed upon at a later date. Yet another approach is to leave the selection of the third party to one of the parties to the countertrade agreement.

(a) Selection of third party by party committed to purchase

45. [41] It often occurs in offset transactions that the selection of the third party supplier is left to the party committed to purchase. That selection may be restricted by guidelines established in the countertrade agreement requiring the selection of suppliers from particular geographical regions or industrial sectors, or of suppliers of specific types of products or services. Such guidelines are referred to in chapter IV, "Countertrade commitment," paragraph 28.

46. [42] When the party committed to purchase is to select the third-party supplier, it is advisable to clarify in the countertrade agreement the effect of a failure by a potential third-party supplier to conclude a supply contract. When the selection is to be made from a large number of potential suppliers, it may be stipulated that the refusal by a potential third-party supplier would not result in a release from the commitment to purchase. When the third-party supplier is to be selected from a list of identified suppliers, it may be agreed that a refusal by all the suppliers on the list to conclude a supply contract in conformity with the terms of the countertrade agreement would release the party committed to purchase from its

commitment. (For a further discussion of release from the countertrade commitment, see chapter XIII, "Failure to complete countertrade transaction", section B.)

(b) Selection of third party by party committed to supply

47. [43] In some cases, the selection of third-party suppliers is left to the party who has a right under the countertrade agreement to supply goods. This may be the case when the party purchasing goods in one direction does not engage in the sale of goods that are to be supplied in the other direction (e.g., when a government agency purchases goods in an offset transaction), does not have goods of interest to the party committed to purchase, or is uncertain as to whether it will have suitable goods at the time the supply contract is to be concluded and therefore wishes to have the option of designating a third-party supplier.

48. [new paragraph] The party committed to supply may be left free to designate the third-party supplier. This may be the case, for example, if the countertrade goods are of a standard quality and readily available. Alternatively, the countertrade agreement may provide guidelines within which the party committed to supply goods may designate the third-party supplier or the countertrade agreement may list the potential third-party suppliers. The party committed to purchase may wish to include in the countertrade agreement a clause providing that purchasing from a third party should not cause additional costs to the party committed to purchase.

49. [44] When the selection of the third-party supplier is left to the party originally committed to supply goods, the countertrade agreement may provide that the third party must be in a position to make available goods that conform to the terms of the countertrade agreement. It is advisable for the countertrade agreement to be clear as to the consequences of a failure by the third party to make the agreed goods available. It may be agreed that such a failure would release the party committed to purchase from the countertrade commitment to the extent that the third party failed to make goods available, or it may be agreed that a new supplier would be selected. When the obligation of the party originally committed to supply is supported by a liquidated damages or penalty clause, or by a guarantee, it may be clarified that a failure by the third party to make the goods available would entitle the party committed to purchase to payment under the liquidated damages or penalty clause or under the guarantee. *

50. [new paragraph] It is advisable that the obligations assumed by the third party are coordinated with the obligations under the countertrade agreement of the party originally committed to supply. This is particularly important with respect to the obligations as to the quality, quantity or price of goods to be delivered, a guarantee of availability of goods, or liquidated damages or a penalty for a failure to make the goods available. The purpose of the coordination is to ensure that the goods offered by the third party to the party committed to purchase would be in accordance with the countertrade agreement. If, for example, the third party does not make available goods that meet the level of quality stipulated in the countertrade agreement and a supply contract is therefore not entered into, the party originally committed to supply would be liable under the countertrade agreement and the party committed to purchase may be released from the countertrade commitment.

51. [new paragraph] The contract between the party originally committed to supply and the third party may include a "hold-harmless" clause, whereby the third party agrees to indemnify the party originally committed to supply for the liquidated damages or a penalty that might have to be paid under the countertrade agreement as a result of a failure of the third party to make the agreed goods available.

52. [new paragraph] In some transactions, the party originally committed to supply and the third-party supplier agree that a commission will be paid by the third-party supplier to the party originally committed for the opportunity to market goods.

D. Multi-party countertrade

53. [45] There are three types of countertrade transactions that involve more than two parties but are distinct from the transactions covered in sections B and C of this chapter.

54. [46] One type is a tripartite transaction in which a party who supplies goods in one direction does not, at any point in the transaction, make a commitment to purchase goods in the other direction; instead, that commitment to purchase is assumed from the outset by a third party. By contrast, section B covers cases in which a party, after having assumed a commitment to purchase goods, engages a third party to make those purchases. A tripartite structure of this first type may be used, for example, in a buy-back transaction in which the exporter of the production facility does not wish to become involved in the purchase of the resultant products and there is a need, in order to secure financing, to have, at the outset, a third party committed to purchase those products. A tripartite transaction of this type may be initiated through the conclusion by the three parties of an agreement stipulating their commitments to enter into the future supply contracts and then to conclude the supply contracts in the two directions. Another approach is for the exporter and the importer to conclude a contract for the supply of goods in one direction, while at the same time the third-party purchaser (counter-importer) and the counter-exporter enter into a commitment to conclude a future contract for the supply of goods in the other direction.

55. [47] A second type of multi-party transaction is a tripartite arrangement in which a party who purchases goods in one direction does not, at any point in the transaction, assume a commitment to supply goods in the other direction; instead, a third-party supplier assumes, at the outset, a commitment to supply goods. This type of tripartite transaction is distinct from the two types of transactions covered in section C: transactions in which a party, after having assumed a commitment to supply goods, designates a third party to supply those goods, and indirect offset transactions, in which the counter-importer makes a commitment to the importer to negotiate supply contracts with potential suppliers who have not made a commitment to conclude supply contracts with the counter-importer. One contractual approach for this type of tripartite transactions is for the three parties to conclude an agreement stipulating their commitments to enter into the future supply contracts and then to conclude the supply contracts in the two directions. Another approach is for the exporter and the importer to conclude a contract in one direction simultaneously with the assumption by the third-party purchaser (counter-importer) and the counter-exporter of a commitment to conclude a future contract for the supply of goods in the other direction.

56. [48] In many cases, a feature of the tripartite transactions described in the previous two paragraphs is the linkage of payments for the supply contracts in the two directions. The use of such linked payment mechanisms is discussed in chapter IX, "Payment", paragraphs 68, 75 and 76.

57. [49] In a third type of multi-party transaction, the supply contract in one direction is concluded by one set of parties and the supply contract in the other direction is concluded by two other parties. Such a four-party countertrade transaction may be established when the parties to a contract for the supply of goods in one direction are not themselves in a position to conclude a supply contract in the other direction but are interested in the conclusion of such a supply contract. There may be interest in such an arrangement because the conclusion of the second supply contract would enable the parties to link payments for the contracts in the two directions so as to avoid or reduce cross-border currency transfers (linkage of payments in four-party transactions is discussed in chapter IX, "Payment", paragraphs 69, 75 and 77). Another reason for being interested in such an arrangement may be that the supply of goods in one direction is subject to a mandatory requirement of a purchase of goods in the other direction.

58. [new paragraph] It is advisable for the parties to consider at the outset of the transaction the question whether the failure to conclude or perform one of the supply contracts should have an effect on the obligation to conclude or perform another supply contract. This question is discussed in chapter XIII, "Failure to complete countertrade transaction", section E. For a discussion of interdependence between supply contracts when the parties have agreed on linked payments, see chapter IX, paragraphs 72 and 73.

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INTERNATIONAL COUNTERTRADE

Draft Legal Guide on International Countertrade Transactions

Report of the Secretary-General

Addendum

IX. PAYMENT

Contents

	Paragraphs
A. General remarks	1 - 8
B. Retention of funds by importer	9 - 13
C. Blocking of funds	14 - 37
1. General remarks	14 - 18
2. Blocked accounts	19 - 30
(a) Countertrade agreement	21 - 25
(i) Location of account	21 - 22
(ii) Operation of blocked account	23 - 24
(iii) Other issues	25
(b) Blocked account agreement	26 - 30
(i) Parties	27
(ii) Transfer of funds into and out of account	28 - 29
(iii) Duration and closing of account	30
3. Crossed letters of credit	31 - 37
(a) Sequence of issuance	32 - 33
(b) Instructions for allocation of proceeds	34 - 36
(c) Expiry dates	37

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	Paragraphs
D. Setoff of countervailing claims for payment	38 - 57
1. General remarks	38 - 44
2. Countertrade agreement	45 - 57
(a) Effecting credit and debit entries	45 - 48
(b) Calculation of entries	49 - 50
(c) Statements of account	51
(d) Periodic verification	52
(e) Limits on outstanding balance	53
(f) Settlement of outstanding balance	54 - 56
(g) Guarantee for payment of outstanding balance	57
E. Issues common to linked payment mechanisms	58 - 65
1. Currency or unit of account	58
2. Designation of banks	59
3. Interbank agreement	60 - 61
4. Transfer of unused or excess funds	62 - 63
5. Supplementary payments or deliveries	64
6. Bank commissions and charges	65
F. Payment aspects of multi-party countertrade transactions	66 - 77
1. General remarks	66 - 73
2. Blocking of funds in multi-party countertrade	74 - 77

[Editorial note: The present draft chapter is a revision of draft chapter IX, "Payment", published as document A/CN.9/332/Add.6. The note in square brackets at the beginning of each paragraph indicates either the number under which the paragraph appeared in document A/CN.9/332/Add.6 or that the paragraph is new. The revisions of paragraphs that appeared in document A/CN.9/332/Add.6 are underlined.]

A. General remarks

1. [1] The parties may decide that the payment obligation under the supply contract in one direction is to be liquidated independently from the payment obligation under the supply contract in the other direction. When payments are independent, the payment under each supply contract is made in a way that is used in trade generally, such as payment on open account, payment against documents, or letters of credit. Alternatively, the parties may decide to link payment so that the proceeds generated by the contract in one direction would be used to pay for the contract in the other direction, thus allowing the transfer of funds between the parties to be avoided or reduced. The legal guide discusses only linked payment arrangements. It does not discuss independent payment arrangements since they do not raise issues specific to countertrade.

2. [2] One reason the parties may have for linking payments is the possibility that it would be difficult for a party to effect payment in the agreed currency. Another reason may be to ensure that the proceeds generated by the shipment in one direction would be used to pay for the shipment in the other direction. Payment mechanisms designed to meet such needs include retention of funds by the importer (below, paragraphs 9 to 13), blocking funds paid under the export contract through blocked accounts or crossed letters of

credit to secure their availability to pay for the counter-export contract (below, paragraphs 14 to 37), and setoff of countervailing claims for payment (below, paragraphs 38 to 57).

3. [3] An aspect of linked payment mechanisms to be considered is the financing costs that result from the fact that linked payment mechanisms immobilize the proceeds of shipments made by the parties. The longer the interval between the time the proceeds are generated by the contract in one direction and the time those proceeds are used to pay for the contract in the other direction, the greater the financing costs are likely to be.

4. [new paragraph] A characteristic of linked payment mechanisms is the security they provide to the party who has received goods first in that the funds to pay for those goods are not placed at the disposal of the party who has supplied those goods but are reserved to pay for goods subseqently to be supplied in the other direction. This fact may make it easier for that party to obtain a loan to finance its deliveries. The source of financing is often the bank that is holding the funds to be used for paying subsequent deliveries or the bank that is administering a setoff of countervailing claims for payment.

5. [new paragraph] On the other hand, the party who is the first one to deliver goods, or who has delivered more goods than it has received, faces the risk that it will have to wait for an uncertain period of time before goods of the agreed quality are made available for purchase in return or, if such goods are not made available, that the proceeds from the deliveries that that party had made are released to pay for those deliveries. Because of this risk, a bank may be reluctant or unwilling to finance a delivery of goods if payment for those goods is to be deferred until the goods are purchased in return. As a result, in large-scale and long-term projects such as buy-back or indirect offset transactions it is less likely that a linked payment mechanism will be used.

6. [4] The parties may wish to consider the possibility that hindrances might arise in carrying out the linked payments. For example, a creditor of one of the countertrade parties might obtain a court order to seize proceeds of a supply contract, the bank holding the funds might become insolvent, or a payment may be prevented because of supervening banking or foreign exchange regulations. Those cases could result in the freezing of the payment mechanism until the claim against the countertrade party was adjudicated, the bank became solvent or the regulations were lifted, as the case may be. A factor in assessing this risk is the degree of protection the law applicable to the payment mechanism affords against such external circumstances. Furthermore, the longer funds are held in the payment mechanism, or claims for payment wait to be set off, the greater the risk that such hindrances might arise.

7. [5] It should be noted that payment mechanisms may require governmental authorization if they involve a delay in or an absence of repatriation of the proceeds of a supply contract, the holding of funds abroad or the holding of a domestic account in a foreign currency.

8. [new paragraph] It is advisable that the parties agree on the details of the linked payment mechanism in the countertrade agreement. Depending on the type of the payment mechanism chosen, individual supply contracts may have to contain clauses implementing the method of payment agreed upon in the countertrade agreement.

B. Retention of funds by importer

9. [6] Sometimes it is agreed that the shipment in a particular direction (export contract) is to precede the shipment in the other direction (counter-export contract), and that the proceeds of the export contract are to be used to pay for the subsequent counter-export. Such cases are sometimes referred to as "advance purchase" in view of the fact that the importer is to purchase goods in advance in order to generate financing for the counter-export contract. In such cases, the parties may agree that the proceeds of the export contract will be held under the control of the importer until payment under the counter-export contract becomes due.

10. [7] A consideration as to the acceptability of such an arrangement would be the exporter's confidence that the importer will hold the funds in accordance with the countertrade agreement. Such confidence is more likely to exist when the parties have an established relationship. Another consideration is the risk that the importer will become insolvent or that the funds in the hands of the importer will be subject to a third-party claim. Under ordinary circumstances the claim of the exporter would have no priority over that of another creditor of the importer. In some legal systems, the funds may enjoy a degree of protection against the claims of third parties if the agreement concerning the retention of funds places the importer in a fiduciary position with respect to the funds. For example, in common law systems, this might be done by establishing a "trust" in which the importer acts as the "trustee" of the funds. Fiduciary mechanisms available in some other legal systems may offer similar protection.

11. [8] Furthermore, a disagreement may arise over the type, quality or price of counter-export goods if the countertrade agreement does not specify the type of goods to be counter-exported, or if no standard exists to measure the quality of the type of goods agreed upon. The possibility of such a disagreement increases the risk that for an unacceptable period of time the retained funds will neither be put to the intended use nor released to the exporter. When the parties are able to specify the type of goods, a consideration affecting the acceptability of retention of funds by the importer may be the length of time required to make the counter-export goods available. Retention of funds by the importer might be more acceptable when the goods to be purchased with the retained funds are available in stock and can be shipped quickly, and less acceptable when the goods have to be specially manufactured.

12. [9] An appropriate balance needs to be established between two opposing objectives. One objective is to assure the exporter access to the funds if the counter-export did not take place. The other objective is to assure the importer that the funds will not be transferred to the exporter, at least not the full amount, if the exporter is in breach of the commitment under the countertrade agreement to counter-import. The first objective may be advanced by fixing a date by which the funds have to be transferred to the exporter in the event the counter-export has not taken place. The second objective may be advanced by authorizing the importer to deduct any liquidated damages or penalty that may be due to the importer for the exporter's breach of the countertrade commitment before the funds are transferred to the exporter.

13. [10] Depending upon the length of time the funds are to be retained under the control of the importer, the parties may wish to consider providing in the countertrade agreement for the payment of interest in favour of the exporter. If they do so, the parties may stipulate the manner in which the funds are to be deposited so as to earn interest at the most favourable rate.

C. Blocking of funds

1. General remarks

14. [11] When the exporter does not wish to leave the funds generated by the export contract under the control of the importer, the parties may wish to use another payment mechanism designed to ensure that the proceeds of the first shipment are used for the intended purpose. The legal guide addresses two mechanisms of this type: blocked accounts and crossed letters of credit.

15. [12] When the parties opt for a blocked account, they agree that the importer's payment is to be deposited in an account at a financial institution agreed upon by the parties and that the use and release of the money will be subject to certain conditions. After the funds have been deposited in the account, the importer counter-exports and obtains payment from those funds by presentation of agreed upon documentation evidencing the performance of the counter-export contract to the institution administering the account. Accounts of this nature have been referred to as "escrow", "trust", "special", "fiduciary" or "blocked" accounts. The expression "blocked account" is used here in order to avoid unintended references to particular varieties of such accounts that may be encountered in different legal systems.

16. [13] When the parties opt for crossed letters of credit, the importer opens a letter of credit to cover payment for the export contract ("export letter of credit"). The export letter of credit then serves as the basis for the issuance of a letter of credit to pay for the counter-export contract ("counter-export letter of credit"). Pursuant to the instructions of the parties, the proceeds of the export letter of credit are blocked in order to cover the counter-export letter of credit. The export letter of credit is liquidated when the exporter presents the required documents, including an irrevocable instruction that the proceeds should be used to cover payment under the counter-export letter of credit. Payment under the counter-export letter of credit, which is funded by the export letter of credit, is effected upon presentation of the required documents by the counter-exporter.

17. [14] A blocked account or crossed letters of credit may be used when the importer does not wish to ship the counter-export goods until the availability of funds to pay for those goods is secured. In such "advance purchase" arrangements, both blocked accounts and crossed letters of credit provide security that the funds generated by the shipment in one direction, specifically designated to occur first, would be used to pay for the subsequent shipment in the other direction.

18. [15] The financial drawbacks of blocking funds may be mitigated to some degree if interest accrues on the blocked funds. A bank holding funds designated for paying letters of credit may be less inclined to pay interest than a bank holding funds in a blocked account. For this reason, a blocked account may provide an interest-bearing vehicle for holding excess funds in

anticipation of future orders. This may be helpful in cases where the parties are not certain at the outset as to whether all the proceeds generated by the export will be needed to pay for the counter-export.

2. Blocked accounts

19. [16] Some legal systems provide special legal regimes for blocked accounts if they are established in a particular legal form (e.g., "trust" account or "compte fiduciaire"). In those legal systems, a blocked account would be subject to general contract law if it is not established in such a particular form. When a special legal regime is applicable, the holder of the funds is subject to special fiduciary obligations with respect to the disposition of the funds and the funds may enjoy a degree of protection against seizure by third-party creditors.

20. [17] Contractual provisions outlining the agreement of the parties on the blocked account will be found in the countertrade agreement. In addition, an agreement will have to be concluded between the bank and one or more of the countertrade parties ("blocked account agreement", below, paragraphs 26 to 30). The provisions in the supply contracts concerning the blocked account will normally be limited to identifying the account to be used for payment.

(a) Countertrade agreement

(i) Location of account

21. [18] The parties should consider stipulating in the countertrade agreement the location of the account, by identifying the bank, by indicating the country in which the account is to be opened or by providing some other criterion for the selection of the bank. The choice of possible locations of the account may be limited if the national law of the party whose shipment generated the funds restricts the right to hold currency abroad. In such a case the choice may be limited to establishing the account with a bank located in that party's country.

22. [19] When the parties have a choice as to the location of the bank, they should bear in mind that the location of the account may determine the law applicable to the account. The suitability of the applicable law in a given location may be assessed in view of the security provided to the parties that the fiduciary obligations of the bank will be properly exercised. Furthermore, it is desirable that the applicable legal regime provide some protection against interference by a third-party creditor of one of the parties. As noted above in paragraph 19, a degree of protection may be available under some legal systems against claims of third persons.

(ii) Operation of blocked account

23. [20] It is advisable that the countertrade agreement contain certain basic provisions to be incorporated in the blocked account agreement with the bank. Such provisions enable each party, upon agreeing to the use of a blocked account, to establish that the account will have the features it considers important. These provisions concern, in particular, procedures for the transfer of funds into the account, documentary requirements for transfer of funds out of the account (e.g., payment request using a prescribed form, bill of lading or other shipping document, certificate of quality) and

interest. In addressing the contents of the blocked account agreement in the countertrade agreement, the parties should be aware that the bank is likely to be accustomed to handling blocked accounts on the basis of contract forms or standard conditions.

24. [21] The countertrade agreement may provide that payments into the account would be made through a letter of credit opened by the importer in favour of the exporter. It may also be agreed that disbursement of the funds held in the account would be carried out through a letter of credit opened by the counter-importer in favour of the counter-exporter. In such cases it is advisable that the countertrade agreement specify the instructions to be given to the issuing banks and the documents to be presented under the letters of credit. For example, the beneficiary would be required to present, along with documents evidencing shipment, an irrevocable instruction that the proceeds should be deposited in the blocked account.

(iii) Other issues

25. [22] It is advisable that the countertrade agreement address issues such as amount of funds to be blocked, interest, transfer of unused or excess funds, and any supplementary payments (for a discussion of various issues common to linked payment mechanisms that might be dealt with in the countertrade agreement, see below, paragraphs 58 to 65).

(b) Blocked account agreement

26. [23] The blocked account agreement would contain instructions to the bank and specify the actions to be taken by the trading parties and by the bank, as well as other provisions concerning the operation of the blocked account. The blocked account agreement would also address issues such as interest and bank charges, and the manner in which trading parties may verify the accuracy of interest calculations and other actions taken by the bank in administering the account. It is important to ensure that the blocked account agreement is consistent with the provisions in the countertrade agreement concerning the blocked account.

(i) Parties

27. [24] The blocked account agreement will be concluded between the bank holding the account and one or more of the countertrade parties. In some cases, an additional bank may be a signatory to the blocked account agreement. That may occur where the funds to be paid into the account are to be channelled, by agreement or by mandatory law, through a particular bank. Some national laws require that a blocked account established abroad be held in the name of its central bank and that that bank be a party to the blocked account agreement. In multi-party countertrade situations where the counter-exporter or counter-importer is distinct from the exporter and importer, the additional trading party may also be party to the blocked account agreement.

(ii) Transfer of funds into and out of account

28. [25] The blocked account agreement would set out procedures customarily used by the bank in administering a blocked account. It is advisable that the parties make sure that their agreement as to the manner in

which the funds are to be paid into the account and disbursed from the account to the counter-exporter (see above, paragraphs 23 and 24) is reflected in the blocked account agreement. It may be useful to indicate whether partial drawings are permitted, the manner in which the amount to be paid is to be determined (e.g., on the basis of the face value of the invoice) and whether notification of payment requests would be made to the party that deposited funds in the account. The blocked account agreement would also describe the conditions under which excess or unused funds should be transferred to the exporter, or applied according to its instructions (see below, paragraphs 62 and 63). In the latter case, the blocked account agreement may indicate the terms on which funds would be held before instructions are received from the exporter.

29. [26] It should be noted that the bank holding the blocked funds may require that its responsibility be limited to examining the conformity of the documents included in the counter-exporter's request for payment with the agreed upon requirements, rather than ascertaining whether the underlying contract has been performed. The bank may also require that the counter-exporter, who will be paid from the account, indemnify the bank against costs, claims, expenses (other than normal administrative and operating expenses) and liabilities which the bank may incur in connection with the blocked account.

(iii) Duration and closing of account

30. [27] In order to ensure the availability of the blocked account for the necessary period of time, the blocked agreement should specify that the account will remain open until a certain date or for a period of time following the entry into force of the countertrade agreement. The parties may wish to provide that the blocked account would remain operative for a period of time (e.g., 60 days) following the end of the period for the fulfilment of the countertrade commitment. Such a time period would enable the transaction to be completed as planned in the event that shipment under the counter-export contract took place just before expiry of the fulfilment period or was delayed for justified reasons. The blocked account agreement could indicate, in addition to the passage of an agreed upon period of time, circumstances in which the account would close. These could include an event such as termination of the export contract or of the countertrade agreement.

3. Crossed letters of credit

31. [28] Where the parties wish to block funds using crossed letters of credit, it is advisable that the countertrade agreement include provisions concerning the designation of the participating banks (see below, paragraph 59), the instructions to be given to the participating banks for the issuance of the export letter of credit and the counter-export letter of credit and for the allocation of their proceeds, and the documents to be presented in order to obtain payment. In addition, the parties would have to stipulate that the shipment and presentation of documents in one direction should precede the shipment and presentation of documents in the other direction.

(a) Sequence of issuance

32. [29] The parties may agree that the counter-export letter of credit should be issued prior to the issuance of the export letter of credit. Such a

sequence of issuance may be an important consideration to a counter-exporter whose motive to conclude the import contract was the expectation of being able to counter-export. The failure to issue the counter-export letter of credit, and the resultant absence of a counter-export, may leave the importer liable for costs associated with the import that the importer had originally intended to cover by the proceeds of the counter-export (e.g., commission to a third person for resale of goods purchased under the export contract). In order to protect the interest of the exporter who agrees to open the counter-export letter of credit before the export letter of credit is issued, the parties may agree that payment under the counter-export letter of credit will require documentary proof of the issuance of the export letter of credit.

33. [30] In some cases the parties may decide to open the counter-export letter of credit only when the proceeds of the export letter of credit would be available to cover the counter-export letter of credit. In order to address the risk that the export letter of credit is opened without the counter-export letter of credit being subsequently issued, the parties may wish to include an appropriate liquidated damages or penalty provision in the countertrade agreement.

(b) Instructions for allocation of proceeds

34. [31] The instructions from the importer for the issuance of the export letter of credit should provide that the documents required to be presented to obtain payment include irrevocable instructions from the exporter that the proceeds of the export letter of credit should be used to pay for the counter-export letter of credit upon presentation of the shipping documents relating to the counter-export. The instructions for issuance of the counter-export letter of credit should indicate that payment is to be made using the proceeds of the export letter of credit.

35. [32] Because of the linkage between the proceeds of the export letter of credit and the counter-export letter of credit the choice as to the method of payment of the export letter of credit is limited to payment at sight or payment on a deferred basis. Payment by a bill of exchange, the other option used in practice to defer payment of a letter of credit, is incompatible with the linked payment objective of the crossed letters of credit. When a bill of exchange is used for paying the beneficiary of the letter of credit, the bank obligated to pay would accept the bill drawn by the importer in favour of the beneficiary of the letter of credit. Such a bill gives the beneficiary the possibility to transfer the bill by endorsement to a third person. If the bill were endorsed to a third person, the bank that issued the export letter of credit and accepted the bill would be obligated to pay the holder of the bill (and the importer would be obligated to reimburse the bank that issued the export letter of credit) independently of the crossed-letter-of-credit payment scheme. If the export letter of credit is payable at sight, the bank issuing the export letter of credit is given an irrevocable instruction to retain the funds until a given date for the purpose of paying the counter-export letter of credit. If the export letter of credit is a deferred-payment letter of credit, the bank issuing the export letter of credit would be instructed that, upon the date payment is due, the funds are to be used for payment under the counter-export letter of credit.

36. [33] It is advisable that the instructions for the issuance of the export letter of credit stipulate that the proceeds of the export letter of credit would be paid to the exporter in the event the counter-export fails to materialize. Under an export letter of credit payable at sight, the proceeds would be paid to the exporter if by an agreed date the counter-export goods have not been shipped. If the export letter of credit is payable on a deferred basis, it could be provided that the proceeds will be paid to the exporter if, by the payment date, the counter-exporter has not presented the required documents. Payment to the exporter would also be in order when the proceeds of the export letter of credit exceed what is needed to cover the counter-export letter of credit. If such a situation is foreseen, it is advisable that the importer instruct the issuer of the export letter of credit to transfer to the exporter any proceeds of that letter of credit that are in excess of the specified amount needed to cover the counter-export letter of credit.

(c) Expiry dates

37. [34] It is advisable that the counter-export letter of credit expire a reasonable period of time after the expiry of the export letter of credit. Where the two letters of credit have an identical or almost identical expiry date, insufficient time may remain for shipment and presentation of documents under the counter-export contract if shipment and presentation of documents under the export contract took place at the last minute.

D. Setoff of countervailing claims for payment

1. General remarks

38. [35] The parties may agree that their mutual claims for payment based on shipments made in each direction would be set off. Under such an arrangement, money is not actually paid; instead, the sum of claims arising from the deliveries in one direction are set off against the sum of claims arising from the deliveries in the other direction. If an outstanding balance arises in the values of the deliveries in the two directions, it can be settled by delivery of additional goods or by payment of money. In some States setoff arrangements are subject to governmental authorization.

39. [36] A setoff approach may be utilized when only one shipment is to be made in each direction or when multiple shipments are to be made in the two directions over a longer period of time. This section discusses the record-keeping mechanism that the parties may wish to use to set off payment claims of multiple shipments. Such a record-keeping mechanism, referred to in the legal guide as a "setoff account", is referred to in practice by various terms, including "compensation account", "settlement account" or "trade account".

40. [37] A setoff account may be administered by the parties themselves or by a bank. The engagement of a bank may be prescribed by mandatory rules of law. Banks are also used because the parties may wish that the debit and credit entries in the setoff account be made on the basis of shipping documents examined in accordance with procedures customarily used by banks. Furthermore, banks engaged to administer a setoff account may agree to guarantee the obligation of a countertrade party to liquidate an outstanding balance in the flow of trade.

41. [38] Under one approach to structuring a setoff account, two accounts are maintained for recording debit and credit entries, one at a bank in the country of one party and another one at a bank in the country of the other party. Another approach would be to use a single account administered by a single bank; other banks may be involved for the purpose of forwarding documents and issuing or advising letters of credit.

42. [39] When two banks are involved in administering the setoff arrangement, it is probable that they will conclude an interbank agreement. This interbank agreement may cover some of the points already addressed in the countertrade agreement, as well as establish the technical arrangements relating to the setoff account. The countertrade agreement may refer to the interbank agreement, stating that the technical details of the operation of the accounts will be in accordance with an interbank agreement concluded between the participating banks. Although the countertrade parties are not normally signatories to an interbank agreement, it is advisable that the countertrade parties participate in the preparation of the interbank agreement in order to ensure consistency between the countertrade agreement and the interbank agreement (interbank agreements are discussed below in paragraphs 60 and 61).

43. [new paragraph] An agreement to set off claims arising from a trade relationship is in a number of national laws recognized as a distinct type of contract involving the two parties in the trade relationship and a third person who is to administer the recording of mutual claims. Terms used for such contracts include "compte courant", "cuenta corriente" or "Kontokorrent", although some of these terms are also used for accounts in which a bank holds funds of a client. Those national laws deal with issues such as obligations of the third person administering the setoff, the effect of the entry of a claim in the setoff account, the action necessary for the setoff of the countervailing claims to take effect, the possibility to dispute an individual claim or the balance of the countervailing claims, or the effect of insolvency or bankruptcy of a party on the individual entries in the setoff account.

44. [40] The legal guide does not address State-to-State umbrella agreements for mutual trade within the framework of a clearing account between governmental banking authorities. Under such arrangements the value of deliveries in the two directions is recorded in a currency or unit of account and eventually set off between the governmental banking authorities. Individual traders in each country conclude contracts directly with each other but submit their claims for payment to their respective central or foreign trade bank and receive payment in local currency. Similarly, purchasers pay their respective central or foreign trade bank in local currency for their imports. Such clearing mechanisms, which might be part of economic measures designed to promote trade, fall outside the ambit of the legal guide since the individual supply contracts in one direction concluded under the umbrella agreement are not contractually linked to contracts concluded in the other direction.

2. Countertrade agreement

(a) Effecting credit and debit entries

45. [41] The parties may wish to agree that entries in the account will be triggered by presentation of documents. The countertrade agreement should

stipulate the documents required to be presented by the supplier in order to obtain a credit. The type of documents stipulated depends on the point of time in the execution of a supply contract at which the parties wish to allow credit to be given to the supplier. These documents might include, for example, invoices, packing lists, certificates of quality or quantity, bills of lading or other transport documents, evidence of the customs clearance of the goods in the receiving country or of their acceptance by the purchaser, and any other documents stipulated under the individual supply contracts. The parties may also wish to agree on the contents of any statement which the supplier would be required to make concerning the transaction being credited (e.g., purchase order number, date of shipment, description of the type, quantity and value of the goods, number and weight of the packages, particulars concerning carriage, and reference to the setoff account.)

46. [42] Where it is agreed that entries in the account are to be made on the basis of events occurring in the country of destination (e.g., customs clearance or acceptance by the purchaser), the parties may wish to maintain a parallel record of shipments already in transit, but not yet cleared by the customs authority or accepted by the purchaser. Such a parallel mechanism would provide an indication of the upcoming claims for payment that would be entered in the account once goods in transit have cleared customs or have been accepted by the purchaser. This information would enable the parties to apply certain provisions of the setoff mechanism (e.g., limits on outstanding balance, below, paragraph 53, and settlement of such balance, below, paragraphs 54 to 56) with greater flexibility than might otherwise be the case. For example, the parties may agree that the application of a balance limit to a party in a debit position could be suspended if the value of goods in transit were to be taken into consideration. This would permit a party who would otherwise be barred from receiving additional shipments of goods to continue receiving goods.

47. [43] In a setoff arrangement comprised of a single account, the parties may agree that the presentation of the agreed documents to the administering bank triggers the appropriate debiting or crediting action. A setoff arrangement comprised of two accounts could operate as follows: the purchaser, through its bank, submits to the supplier's bank a copy of a purchase order, and any other documents stipulated in the countertrade agreement or specified in the purchase order. On receipt of the required documents, the supplier's bank debits the purchaser's account. Upon passing the debit entry, the supplier's bank forwards the documents to the purchaser's bank, along with a statement concerning the effective date of the debit entry. The effective date of the debit entry, as agreed upon in the interbank agreement, may be, for example, the date when the documents are dispatched by the supplier's bank to the purchaser's bank. Upon receipt of the documents, the purchaser's bank makes in its books a corresponding credit entry in the supplier's account.

48. [44] Because a setoff account is used for recording the values of shipments rather than for making payments, the use of letters of credit is not necessary. When letters of credit are used, they are used in order to apply established procedures for examination of shipping documents rather than for transferring money. In such cases, the stipulations in the countertrade agreement concerning the instructions to be given to the issuing banks should be aligned with the current revision of the Uniform Customs and Practice for Documentary Credits prepared by the International Chamber of Commerce, which banks customarily incorporate into their letter-of-credit forms.

(b) Calculation of entries

49. [45] The countertrade agreement should indicate the currency or unit of account in which the values of the deliveries are to be expressed (below, paragraph 58). In addition, the parties may wish to address the question whether interest calculated on the amount of an outstanding balance would be registered in the setoff account. Furthermore, the parties may wish to stipulate whether debit and credit entries can be made only on the basis of the required documents evidencing shipment or also on the basis of any claims arising from defective goods or delayed shipment. If debit and credit entries are made only on the basis of shipping documents, claims relating to defective performance of supply contracts would be settled apart from the setoff mechanism. If, however, the parties agree that claims based on defective performance of supply contracts would affect the balance of the setoff account, it is advisable to stipulate the types of documents that would have to be presented in order to alter the balance of the setoff account. For example, the countertrade agreement could require an arbitral award, or a statement by the defaulting party, indicating the amount involved.

50. [46] In order to protect the setoff mechanism against uncertainty that may result from taxation, the parties and the banks may agree that taxes will not appear in the setoff account. Such a provision is intended to facilitate the trade balancing aim of the clearing mechanism by allowing the full value of a given shipment to be credited.

(c) Statements of account

51. [47] It is advisable to consider the manner in which the participating bank or banks will report on the status of the setoff account to the trading parties and to any other participating bank. Agreement on this issue is particularly relevant where one bank maintains the account on behalf of both parties. Where two banks are involved, the question of reporting may be covered in the interbank agreement. Issues to be agreed upon include the frequency, timing and contents of the reports, procedure for objections and period of time within which objections must be made before a report is deemed accepted.

(d) Periodic verification

52. [48] In order to minimize the possibility of errors or discrepancies in the setoff account, the parties may agree to verify the recorded value of shipments in the two directions at fixed points of time. The determination of the outstanding balance can be based, for example, on the preceding statement of account that has been accepted and the subsequent debit and credit entries advised in the agreed upon manner. The parties may wish to be specific as to the length of time within which the checking procedure must be completed (e.g., within seven days of the fixed points of time).

(e) Limits on outstanding balance

53. [49] The parties may agree that at any point in time during the course of the setoff arrangement a credit or debit balance in the setoff account with respect to either party should not exceed an agreed upon balance limit. In accordance with such a balance limit (sometimes referred to as a "swing"), debit and credit entries would not be entered in excess of the

balance limit. It could also be provided that shipments of goods would be suspended to a party whose acceptance of goods without shipping a sufficient quantity in return had resulted in a debit balance reaching the agreed upon limit, or that an outstanding balance in excess of the limit is to be settled by transfer of money. Shipments to that party, and the corresponding debit entries, would resume once the debit balance had been brought within the permissible range.

(f) Settlement of outstanding balance [change of title]

54. [50] It is advisable that the parties agree in the countertrade agreement on the manner of settling an outstanding balance in the values of the deliveries in the two directions that remains at the conclusion of subperiods of the fulfilment period or at the conclusion of the fulfilment period.

55. [50] With respect to an outstanding balance remaining at the conclusion of a subperiod, it may be agreed that the balance would be carried over to the next subperiod. Alternatively, it may be agreed that only a balance up to a specified limit would be carried over to the next subperiod, and that the balance in excess of the limit would have to be settled by cash or by deliveries of goods within a specified shorter period of time. The purpose of limiting the amount of an outstanding balance that is carried forward is to prevent the accumulation of a high outstanding balance that would be difficult to rectify by the end of the fulfilment period.

56. [51] As to an outstanding balance remaining at the conclusion of the fulfilment period, it may be agreed that the balance is to be liquidated by a currency transfer within an agreed period of time. Alternatively, the parties may agree that the balance would be settled after the end of the fulfilment period by deliveries of goods within a fixed supplementary period. If an outstanding balance still remains after the conclusion of the supplementary period, it may be stipulated that it is to be settled by a currency transfer within an agreed period of time.

(g) Guarantee for payment of outstanding balance

57. [52] In a setoff arrangement involving two banks, each bank may guarantee the obligation to liquidate any outstanding balance. Where a single account is maintained by one bank on behalf of both parties, a guarantee covering liquidation of an outstanding balance can be maintained by that bank in favour of whichever of the parties has the outstanding credit balance. The parties may agree that the costs of maintaining such a guarantee be apportioned between them. The amount of a guarantee for payment of an outstanding balance is normally limited to the permitted balance limits under the setoff arrangement. (For further discussion of such guarantees, see chapter XII, "Security for performance", paragraphs [38] to [45].) Parties should be aware that there may be cases, however, where remittance of sums claimed under such guarantees would be subject to prior scrutiny and authorization of exchange control authorities. Sometimes it is possible to obtain prior authorization from exchange control authorities for the remittance of the payment under the guarantee.

E. Issues common to linked payment mechanisms

1. Currency or unit of account

58. [53] The parties should designate the currency or unit of account in which the payment mechanism will operate. A factor of particular importance is stability in exchange rates of the chosen currency. Because of this consideration, the parties may wish to consider using a unit of account (e.g., SDR (Special Drawing Right), ECU (European Currency Unit) or UAPTA (Unit of Account of the Preferential Trade Area for Eastern and Southern African States)). Another factor in choosing a currency is that it be one in which the goods to be traded are typically valued. In setoff accounts, the currency in which the account operates takes on the character of a unit of account because payments are not made in setoff accounts except to liquidate an outstanding debit balance in trade. The parties may therefore denominate a setoff account in a currency that they would not use if payments actually had to be made for each shipment.

2. Designation of banks

59. [54] The parties may wish to designate in the countertrade agreement the bank or banks they intend to use to administer the payment mechanism and issue any related letters of credit. When the parties do not designate a bank in the countertrade agreement, they may wish to agree, for example, that the bank would have to have its place of business in a particular country, that the bank must be acceptable to both parties or that the bank selected must be agreeable to an interest-bearing payment mechanism.

3. Interbank agreement

60. [55] Where on each side of the countertrade transaction a bank is involved, the participating banks may conclude an interbank agreement concerning technical and procedural aspects of the payment mechanism. The interbank agreement would cover issues such as: statements of account; procedures for notification of interest due; how often interest is to be recorded; interbank communications for the purpose of advising debit and credit entries and transmission of documents; procedures for verification of entries in accounts; banking charges; and modification and assignment of the interbank agreement. While the countertrade parties are not normally parties to the interbank agreement, they have an interest in the contents of the interbank agreement in view of its role in structuring the payment arrangement. It is therefore advisable that the countertrade parties consult with their banks to ensure that the terms of the interbank agreement are consistent with the terms of the countertrade agreement concerning payment.

61. [56] The entry into force and the duration of the interbank agreement may be linked to the entry into force and duration of the countertrade agreement in order to ensure the availability of the payment mechanism at the time the countertrade transaction is to be carried out. It is desirable to provide for the interbank arrangement to continue beyond the expiry or termination of the countertrade agreement for the purpose of settling any outstanding balance. In order to provide the trading parties an opportunity to approve the interbank agreement, the countertrade parties and participating banks might agree that the interbank agreement will enter into force upon the approval by the countertrade parties. In some countries the interbank agreement may require approval of exchange control or other governmental authorities.

4. Transfer of unused or excess funds

62. [57] It is advisable that the parties provide for payment to the exporter of the proceeds of the export contract, or application of the proceeds according to the exporter's instructions, in the event that the counter-export does not take place by the agreed date. In order to address the concern of the importer about an arbitrary non-fulfilment of the countertrade commitment, it may be agreed that an amount equivalent to the sum that may be due from the exporter as damages, liquidated damages or penalty for breach of the countertrade commitment would be retained or transferred to a third party pending the resolution of a dispute as to responsibility for the non-fulfilment of the countertrade commitment.

63. [58] A similar provision may be included with respect to funds generated by the export that are in excess of the amount needed to cover the price of the counter-export contract. Transfer of unused funds is also an issue when the parties agree that only a portion of the proceeds of the export contract is to be retained (e.g., as a deposit towards payment for the counter-export), and that the outstanding balance due under the counter-export will be paid at the time the balance becomes due.

5. Supplementary payments or deliveries

64. [59] The parties may anticipate that their shipments will not be of equal value or in the planned quantity so that the proceeds of the shipment in one direction will be insufficient to cover payment for the shipment in the other direction. In such cases, it is advisable to agree whether the difference would be settled through additional deliveries or through cash payments.

6. Bank commissions and charges

65. [60] It would be advisable for the parties to address in the countertrade agreement the question of payment of bank charges for operation of the payment mechanism. In order to simplify the operation of the payment arrangement, it may be agreed that bank commissions and charges will be recorded separately from entries pertaining to shipment of goods. Where a single bank is used which acts on behalf of both parties, it may be agreed that the bank charges will be shared equally. Where a bank is involved on both sides of the transaction, it may be agreed that the charges of each bank will be paid by its respective client. For example, it may be agreed that the charges for the issuance of a letter of credit will be borne by the purchaser, while charges for negotiation and confirmation, if required, will be borne by the supplier. Charges for extensions or other amendments of letters of credit could be borne by the party responsible for such extension or amendment.

F. Payment aspects of multi-party countertrade transactions

1. General remarks

66. [61] A countertrade transaction may involve one or more third parties. In some cases, in addition to the exporter and the importer, a third-party counter-importer or a third-party counter-exporter is involved ("three-party countertrade"); in yet other cases, in addition to the exporter

and the importer, both a third-party counter-importer and a third-party counter-exporter are involved ("four-party countertrade") (see chapter VIII, "Participation of third parties", paragraphs ____ to ____). The engagement of a third-party counter-importer may occur when the importer needs to sell goods in order to secure funds to cover the cost of the import, but the exporter is not interested in purchasing or is not able to purchase what the importer has to sell. A third-party counter-exporter may be engaged when the importer itself does not have goods of interest to the exporter.

67. [62] If the parties agree that the payment obligations under the export contract and under the counter-export contract are to be settled independently, a countertrade transaction involving third parties does not raise payment issues specific to countertrade. Issues specific to countertrade are raised if the proceeds of the contract between one pair of parties (e.g., importer and exporter) will be used to pay for a contract between a different pair of parties (e.g., importer and third-party counter-importer). In such cases, as described in the following two paragraphs, a party receiving goods does not pay or ship to the party supplying those goods, but instead pays or ships to a third party.

68. [63] In a three-party countertrade transaction involving a third-party counter-importer, the importer, instead of transferring money to the exporter under the export contract, delivers goods to the counter-importer and is considered to have discharged the payment obligation for the import up to the value of countertrade goods delivered to the counter-importer. The counter-importer, in turn, pays the exporter an amount equivalent to the value of the goods received from the counter-exporter. Similarly, in a three-party transaction involving a third-party counter-exporter, the importer transfers funds to the counter-exporter to pay for the shipment to the counter-importer and the counter-importer (exporter) agrees that the claim for payment under the export contract is discharged by the value of the goods that have been counter-exported to him.

69. [64] In a four-party countertrade transaction, where the counter-exporter is a separate party from the importer and the counter-importer is a separate party from the exporter, the exporter ships goods to the importer and the importer, instead of paying the exporter, pays to the counter-exporter an amount equivalent to the value of the goods received from the exporter. The payment from the importer to the counter-exporter compensates the counter-exporter for the shipment to the counter-importer. The counter-importer pays to the exporter an amount equivalent to the value of the goods received from the counter-exporter.

70. [65] Payment in a multi-party countertrade transaction may be structured so that cross-border payment would not be necessary. This would be possible, as between an importer and an exporter, when the importer and the third-party counter-exporter are located in the same country or when the exporter and a third-party counter-importer are located in the same country. When both the counter-exporter and the counter-importer are third parties, cross-border payments may be avoided if both the exporter and the counter-importer are both located in one country and if the importer and the counter-exporter are both located in another country. Where no cross-border transfer of currency takes place, payments would be made in local currency between parties on each side of the transaction.

71. [66] In multi-party countertrade, in addition to the payment-related provisions in the countertrade agreement and in the export and counter-export contracts, there would also be agreements between the exporter and the counter-importer or between the importer and the counter-exporter concerning payment in local currency equivalent to the value of the goods received by a given party and the payment of a commission. Furthermore, an agreement may be concluded between the participating banks concerning the payment mechanism.

72. [67] If one of the supply contracts in a multi-party countertrade transaction is not concluded or performed as envisaged, it will be impossible to use the proceeds of the contract between one pair of parties to pay for a contract between another pair of parties. In view of this interdependence of supply contracts, it is important that measures are taken that provide assurance to the parties that the obligations under the transaction will be carried out as agreed. Accordingly, it is advisable that the obligations incumbent on each party are set out as clearly as possible, in particular the obligations concerning the quality of goods, the sequence of shipments, the manner and sequence of payments, and the instructions to be given to the participating banks. In order to increase the confidence of parties, the parties may agree to carry out, prior to the conclusion of the transaction, an inspection of goods to be delivered, to identify specifically the goods to be delivered, or to place the goods in the custody of a third person pending delivery. In order to facilitate coordination of the obligations of the parties, it is useful to address them in a single countertrade agreement entered into by all the participating parties. Where not all the parties to the multi-party transaction are parties to the countertrade agreement, it is advisable to include in the individual supply contracts terms concerning the linked payment mechanisms.

73. [new paragraph] In order to make the coordination of obligations of the parties to a multi-party countertrade transaction more effective, the parties may wish to stipulate at the outset of the transaction that certain terms of the countertrade agreement or of a supply contract can be modified only if all parties to the transaction agree to the modification. The modifications that should be subject to agreement of the participating parties are in particular those that concern the time of shipments, method of payment, quantity and quality of goods and price. In addition, the parties may wish to consider securing obligations under the transaction by agreeing on liquidated damages or penalties or on independent bank guarantees.

2. Blocking of funds in multi-party countertrade

74. [68] As in countertrade involving two parties, blocked accounts and crossed letters of credit may be used in multi-party countertrade. Issues relevant to the use of blocked accounts and crossed letters of credit are discussed in above in paragraphs 14 to 37.

75. [69] When a blocked account is used in a four-party transaction, or in a three-party transaction involving a third-party counter-exporter, the proceeds of the export contract would be held in a blocked account until presentation of documents evidencing performance of the counter-export contract, at which point the funds would be transferred to the counter-exporter. In the event that, by the deadline for presentation of documents evidencing performance of the counter-export contract, those documents have not been presented, the funds would be transferred to the

exporter. In order to establish payment through a blocked account, the exporter and importer conclude a blocked account agreement with the bank selected to administer the account.

76. [70] When crossed letters of credit are used in a three-party transaction involving a third-party counter-exporter, the counter-importer (exporter) opens a letter of credit in favour of the counter-exporter (counter-export letter of credit). Cover for the counter-export letter of credit is obtained from the proceeds of the letter of credit opened by the importer for the benefit of the exporter (export letter of credit). The exporter obtains access to the shipping documents relating to the counter-export goods by presenting evidence of shipment under the export contract and an instruction that the proceeds of the export letter of credit should be used to cover the counter-export letter of credit. Similarly, in the case of a three-party transaction involving a third-party counter-importer, the proceeds of the export letter of credit could be used to cover the counter-export letter of credit.

77. [71] When crossed letters of credit are used in a four-party transaction, the importer, who obtains the issuance of the export letter of credit, deposits with the issuing bank of the export letter of credit the amount of that letter of credit. Upon the instruction of the exporter, the proceeds of the export letter of credit are not paid to the exporter, but are blocked to cover the counter-export letter of credit. Upon the presentation by the counter-exporter of shipping documents under the counter-export letter of credit, the funds deposited by the importer to cover issuance of the export letter of credit are paid to the counter-exporter; on the other side of the transaction, the counter-importer pays the exporter an amount equivalent to the value of the goods received by the counter-importer. If the counter-exporter does not present shipping documents under the counter-export letter of credit, the funds deposited by the importer to cover the export letter of credit would be transferred to the exporter.

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INTERNATIONAL COUNTERTRADE

Draft Legal Guide on International Countertrade Transactions

Report of the Secretary-General

Addendum

X. RESTRICTIONS ON RESALE OF COUNTERTRADE GOODS

Contents

	Paragraphs
A. General remarks	1-8
B. Duty to inform or consult	9-10
C. Territorial and related restrictions	11-16
D. Resale price	17-20
E. Packaging and marking	21-22
F. Application to third-party purchasers	23-24
G. Review of restrictions	25-26

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A. General remarks

1. [1] Sometimes the parties agree in the countertrade agreement or in a supply contract to restrictions on the resale of all or of a portion of the goods purchased pursuant to the countertrade commitment. The agreed restrictions may, for example, limit the territory where the purchaser may resell goods, set a minimum resale price, or prescribe packaging and marking of goods to be resold. Such restrictions may be applied to the resale of the goods within the country of the purchaser or to the re-export of the goods. A countertrade agreement or supply contract may contain a combination of different types of resale restrictions.

2. [2] Resale restrictions of this type are not particular to countertrade transactions. However, such restrictions are dealt with in the legal guide because they may take on a special importance in countertrade. Resale restrictions may be part of the strategy of a supplier of countertrade goods or of a government that has mandated countertrade when the purpose of requiring the countertrade commitment was to increase the volume of exports to a particular market or to develop new markets for the goods without affecting adversely existing markets for those goods.

3. [3] The parties should be aware that many legal systems contain mandatory rules on restrictive business practices, and the parties should ensure that a resale restriction they contemplate using is not in contravention of those rules. Such mandatory rules may be set forth in a statute and in various types of administrative regulations, and interpreted by judicial decisions. The mandatory rules of more than one country may apply. Mandatory rules of this type may contain generally worded prohibitions against practices that unduly restrain competition and thereby put competitors or consumers at an unfair disadvantage or harm the national economy. Furthermore, there often exist specific prohibitions against particular types of restrictive business practices. For example, many legal systems provide that agreements restricting the right of resale are prohibited or may be invalidated if the supplier imposing the restriction has a dominant market position, if the restriction has the effect of limiting access to markets or otherwise unduly restraining competition or if the restriction has or may have other adverse effects on trade or economic development. Agreements setting a minimum price are prohibited outright in some legal systems. In other legal systems, minimum price agreements may be permitted only for certain types of goods (e.g., brand-name or luxury goods) or if specified conditions are met (e.g., the price-setting agreement is approved by the competent authority or it is shown that buyers have sufficient possibility to obtain the same or similar goods at prices not subject to a price-setting agreement).

4. [4] In negotiating a restriction on the resale of countertrade goods it is useful to bear in mind that, depending on the commercial circumstances of the transaction, a restriction might lower the price that the countertrade party purchasing and reselling countertrade goods will be able to offer to the countertrade party supplying the goods. Such may be the effect of a clause prohibiting the resale of the goods in the most attractive market, or of a clause requiring resale terms that result in additional costs to the party reselling the goods.

5. [5] When a resale restriction is contemplated, it is advisable to be as specific as possible in the countertrade agreement as to the content of the restriction. Absent a provision in the countertrade agreement on resale restrictions, a demand that the purchase of countertrade goods be subject to a resale restriction may complicate negotiation of a supply contract and may make it difficult to attribute to one of the parties responsibility for a failure to conclude a supply contract. When it is possible that a third party will be engaged to make the purchases necessary to fulfil the countertrade commitment and the third-party purchaser is to be subject to a resale restriction, it is advisable for the supplier to ensure that the third-party purchaser would be aware that its purchases are subject to that restriction (see below, paragraphs 23 and 24).

6. [6] The degree to which the countertrade agreement can be specific depends on factors such as whether the type of goods to be purchased has been identified, the nature of the restriction, or the length of time during which the supply contracts will be concluded, and the possibility of third parties being involved in the resale of the goods. In some cases it may be possible to formulate in the countertrade agreement the resale restriction clause that would apply to all purchases made pursuant to the countertrade agreement. In other cases the supplier may not have the necessary information at the time of the conclusion of the countertrade agreement to determine whether a resale restriction would be desirable, but would not wish to be precluded from raising the question of resale restrictions at a later stage. In such cases, the countertrade agreement may identify only the type or commercial purpose of a resale restriction being contemplated. For example, it may be agreed that the parties would negotiate a limitation of the territories in which the purchaser is permitted to resell goods in order to avoid sales of the goods in the supplier's existing markets.

7. [7] In some exceptional circumstances, the countertrade agreement may contain a stipulation that the purchaser may only use the goods in-house and may not resell them. Such a restriction may be imposed, for example, when the goods are supplied on preferential terms (e.g., in order to help the purchaser in a hardship situation) or when the supplier is under an obligation to restrict distribution of the goods because of their particularly sensitive nature or when the resale of the goods would entail disclosure of information that the supplier wishes to keep under its control.

8. [new paragraph] Parties to a countertrade transaction sometimes include in the countertrade agreement provisions that restrict the freedom of the supplier of countertrade goods to market the type of goods that are the subject-matter of the countertrade transaction. The purpose of such a restriction may be to enhance the purchaser's ability to resell the countertrade goods or to make the countertrade transaction more profitable for the purchaser. For example, the supplier of countertrade goods may agree not

to sell the same type of goods to certain customers or in certain markets. The supplier of countertrade goods might also grant to the other countertrade party exclusive distributorship rights with respect to those goods. The parties might also agree that the supplier will not market the same type of goods at prices lower than those used in the countertrade transaction. Such restrictions applicable to the supplier might be stipulated when in the same transaction the purchaser has agreed to resale restrictions or they may be agreed upon when no resale restrictions have been agreed upon. The warning given in this chapter (above, paragraph 3) that various marketing restrictions may contravene mandatory rules on restrictive business practices is also applicable to marketing restrictions on the supplier of countertrade goods.

B. Duty to inform or consult

9. [8] The countertrade agreement may provide that the party purchasing goods under the countertrade agreement is to inform the supplier as to certain aspects of the resale of the goods, such as the territory of resale, resale price, or packaging or marking of the goods. Information of this kind may be useful to the supplier in monitoring compliance with resale restrictions binding upon the purchaser, in determining whether resale of the goods by the purchaser is achieving the goal of introducing the goods into new markets, in deciding whether to continue to offer those goods in countertrade transactions, in deciding whether the goal of opening new markets or the goal of increasing sales in traditional markets would be served by engaging in further countertrade transactions with the purchaser, or in planning its own marketing or production of the same or similar type of goods. Such an obligation to inform may be agreed upon also when the parties do not agree on a specific resale restriction, for example, because the type of goods to be purchased has not been specified at the time of the conclusion of the countertrade agreement.

10. [9] The countertrade agreement should be clear as to whether an obligation to inform or consult is limited to giving information or is intended to provide an opportunity for consultations between the purchaser and the supplier prior to the resale. It is advisable to stipulate the point of time when the supplier is to be informed. If the parties intend to allow for consultations prior to resale, it should be made clear that the purchaser must inform the supplier in sufficient time to allow consultations to take place.

C. Territorial and related restrictions

11. [10] The parties to a countertrade transaction sometimes agree on restrictions as to the territory where the party purchasing goods under the countertrade agreement may resell the goods. A territorial restriction may be based on the supplier's desire, for example, to generate sales in new markets, to protect the supplier's existing markets, to ensure that the goods comply with the rules applicable in the markets in which they are to be resold, or to avoid violating restrictions arising from patents held by third persons or from licensing arrangements between third persons and the supplier for technology used to produce the countertrade goods. A further reason may be to prevent interference with exclusive distributorships granted by the party supplying goods under the countertrade agreement. If the supplier has granted an exclusive distributorship in a particular territory, it is inherent in such an arrangement that the supplier would be under a duty not to enter into

contractual arrangements that undermine the exclusive distributorship. Sometimes exclusive distributorship agreements provide that the exclusive distributor is entitled to a commission if goods in question are sold in the restricted territory. In such cases the parties to the countertrade agreement might require the purchaser to pay a commission to the exclusive distributor.

12. [11] Identification of the territories where the goods may be resold can be done either by specifying the territories where the goods are not permitted to be resold or by specifying those territories where the goods are permitted to be resold. A provision specifying territories where the goods may be resold should make clear that resale is prohibited in territories that are not listed. The parties should pay attention to the need to use precise terminology. General expressions such as "Caribbean States", "Latin America", "Pacific region", or "Europe" may be interpreted differently and therefore may be inadequate. The territory in which the goods are permitted to be resold may also be limited to those territories in which after-sale service is available either from the purchaser or some other source. In drafting clauses concerning territories of resale, the parties should bear in mind that the right to resell in particular territories is distinct from the question whether the right to resell in those territories is exclusive or non-exclusive.

13. [12] In some cases, the countertrade agreement may provide that only a specified quantity of goods is permitted to be resold in particular territories or that only a specified quantity of goods is permitted to be resold without restriction as to territory. Such an approach may be motivated, for example, by the existence of governmental import quotas, by a desire to avoid oversupply in existing markets or by a desire to introduce the goods into new markets.

14. [13] When the countertrade transaction is likely to result in the resale of goods in markets in which the supplier usually does not sell, the supplier may wish to permit the resale of the goods only in territories in which the goods are covered by product liability insurance for claims arising from personal injury or property damage caused by the goods. It may be agreed that the party purchasing the goods under the countertrade agreement and reselling them is to obtain the insurance. Such insurance may be in the interest of the supplier because claims for damage resulting from the use of the goods may be made against the supplier. A clause permitting the resale of the goods only in territories in which the goods are covered by product liability insurance may be considered in particular when the products purchased under the countertrade transaction are to be resold in a market where the standard of liability or the level of compensation awarded under product liability laws is considerably higher than in the markets in which the products are traditionally sold.

15. [14] Suppliers sometimes prohibit purchasers from selling to particular customers or classes of customers. Such restrictions may be motivated by a desire on the part of the supplier to retain certain customers for itself (e.g., bulk buyers). An aim of this type of restriction may be to prevent competition in the supply of the goods that might result in a lowering of the price. It should be noted that such resale restrictions may violate mandatory rules mentioned above (paragraph 3) prohibiting certain types of restrictive business practices. Another possible motivation for such restrictions may be the prevention of resale of goods of a sensitive or hazardous nature to certain buyers.

16. [15] The parties sometimes agree that the resale of goods requires the consent of the supplier. This approach might be taken, for example, when the nature of the goods requires a restriction on their transfer (e.g., hazardous substances or equipment whose use requires special training) or when the supplier contemplates granting exclusive distribution rights in the future and therefore wishes to retain the right to restrict the resale of the goods by the purchaser once those distributorships have been granted. The requirement of consent may be limited to specified territories or to specified classes of customers. The exercise by the supplier of the right to withhold consent may be made subject to objective criteria. It may be agreed, for example, that consent may be withheld only where the goods are to be resold in a market in which an exclusive distributorship has been established, or where existing sales of the goods in question by the supplier or its distributors have reached a specified threshold.

D. Resale price

17. [16] Sometimes countertrade agreements contain provisions concerning the minimum resale price of the goods. As pointed out above in paragraph 3, the parties should bear in mind that in many States, under mandatory rules relating to restrictive business practices, setting a minimum resale price is permitted only in limited circumstances.

18. [17] The supplier may wish to set a minimum resale price when the goods to be supplied pursuant to the countertrade agreement are of such a quantity that their resale might destabilize or depress the price for goods of that type. While in many countertrade transactions the quantities of goods involved are such that they would not adversely affect the market price, there are countertrade transactions that result in an abrupt and large increase in the supply of goods of a particular type and that may therefore cause price instability. Minimum resale prices may also be intended to prevent sales at discount prices that might harm the image of a product.

19. [18] A minimum resale price may be stipulated in the countertrade agreement or it may be agreed that a minimum resale price is to be set at a time subsequent to the conclusion of the countertrade agreement (e.g., at the time of the conclusion of the supply contract or after a specified volume of the goods has been resold). In the case of a long term countertrade transaction, the parties may agree that a minimum resale price is to be set periodically. The countertrade agreement should be clear as to the charges and costs that are to form part of the stipulated minimum resale price (e.g., transportation costs, insurance premiums, or taxes). If the minimum price is to be set subsequent to the conclusion of the countertrade agreement, the parties may wish to link the determination of the minimum to an objective standard of the type used in setting a price for the goods as between the parties to the countertrade agreement. Such standards include the price quoted in a market of goods of the type in question, competitor's price or the price charged to the supplier's most favoured customer (see chapter VI, "Pricing of goods", paragraphs 11 to 20).

20. [19] The parties may not wish to set a specific minimum resale price in the countertrade agreement when the goods are of a standardized quality, such as commodities, that are sold in public markets because of the possibility that the market price may fall below a specific minimum resale

price set in the countertrade agreement. A purchaser bound by a minimum resale price higher than the market price would find it difficult or impossible to resell the goods. In order to avoid such difficulties, the parties may wish to provide that the minimum resale price is to trace movements in the market price for the goods in question. This could be done by linking the determination of the minimum price to objective standards of the type referred to in the preceding paragraph.

E. Packaging and marking

21. [20] The countertrade agreement may contain requirements as to the type of packaging or marking to be used in reselling the goods. Such requirements may obligate the purchaser to repackage or re-mark the goods or to resell the goods with their original packaging or marking. The question of packaging and marking may be important because a goal of many countertrade transactions is to introduce goods in non-traditional markets. The packaging and marking of the goods may be intended to affect the marketability of the goods in those markets, or to comply with legal rules governing packaging and marking. For example, the countertrade agreement may require that the goods be sold under the supplier's trade name, that the goods be sold in a particular form of packaging, that the packaging list the ingredients and composition of the goods, that the packaging indicate the origin of the goods, or that the packaging include instructions for use and that the instructions be in a particular form.

22. [21] The parties should ensure that any packaging or marking requirements in the countertrade agreement do not conflict with mandatory provisions at the place where the goods are to be resold. For example, there may exist requirements as to marking the origin of goods, prohibitions to modify certain elements of markings or packaging, or requirements derived from consumer protection and environmental law. Even when the countertrade agreement does not prescribe repackaging or re-marking, the purchaser may have to repackage or re-mark the goods when packaging and marking of the goods by the supplier do not conform to the rules applicable in the country where the goods are to be resold.

F. Application to third-party purchasers

23. [22] When it is possible that the party committed to purchase goods will engage a third party to make the purchases, the supplier may be interested in seeing that a resale restriction stipulated in the countertrade agreement will be observed by the third party. For that purpose, the supplier may wish to include in the countertrade agreement a provision obligating the party originally committed to purchase goods to incorporate the resale restriction in the contract through which the party originally committed engages the third party. Furthermore, it is advisable that the supplier include that resale restriction in the supply contract concluded with the third party or in the agreement with the third party by which the third party makes a commitment to the supplier to conclude a future supply contract (see chapter VIII, "Participation of third parties", paragraphs [15] and [16]). In this way the third party would be responsible directly to the supplier for compliance with the resale restriction.

24. [23] As noted in chapter VIII, "Participation of third parties", paragraph [25], the party originally committed to purchase may be liable under the countertrade agreement for a resale of the goods by the third party in violation of a restriction set out in the countertrade agreement. Therefore, the party originally committed would itself have an interest in reflecting in the contract with the third party any resale restriction set out in the countertrade agreement. Furthermore, the party originally committed to purchase goods may wish to include in its contract with the third party a "hold-harmless" clause committing the third party to indemnify the party originally committed to purchase for any liability to the supplier resulting from a violation by the third party of a resale restriction (for a discussion of "hold-harmless" clauses, see chapter VIII, paragraph [33]).

G. Review of restrictions

25. [24] Large-scale countertrade transactions often involve purchase and resale of goods over a long period of time during which the underlying commercial circumstances and interests of the parties may change significantly. The possibility of such changes may make it appropriate to provide in the countertrade agreement for a review of agreed upon resale restrictions. A periodic review or a review upon the request of a party may be agreed upon. When the review is to be upon the request of a party, the countertrade agreement may identify the types of changes in the underlying circumstances that would entitle a party to a review. Even in the absence of a review clause in the countertrade agreement, under some legal systems, in the event of major changes in the circumstances underlying the transaction the parties would be obligated to review the affected restriction.

26. [25] The extent to which a review procedure is advisable would depend upon the nature of the resale restriction in question. For example, a restriction as to the territory or price of resale linked to a particular type of goods may entail a greater need for possible future modification than a restriction of a less stringent sort such as a requirement that the purchaser consult with the supplier prior to reselling the goods.